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In the

Supreme Court of the United States

October Term, 1951

No. 270

HELEN BLESI PEARSON AND J. CHARLES PEARSON, JR.,
Petitioners,
(Respondents in the Court of Appeals and
Petitioners in the Tax Court),

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent,
(Petitioner in the Court of Appeals and
Respondent in the Tax Court).

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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Respondent in the Tax Court).

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Helen Blesi Pearson and J. Charles Pearson, Jr. pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit, entered in the above entitled case on April 11, 1951, reported 188 F. 2d 72, rehearing denied May 24, 1951, reversing the order of the Tax Court of the United States entered herein on November 30, 1949, reported in 13 T. C. 851.

OPINIONS BELOW

The findings of fact and the opinion of the Tax Court of the United States (R. 119-131) are reported at 13 T. C. 851. The opinion of the Court of Appeals (R. 185-191), reversing the trial court and remanding the cause with directions to restore the deficiency, is reported in 188 F. 2d 72.

JURISDICTION

The judgment of the Court of Appeals was entered on April 11, 1951. (R. 192.) Petition for rehearing (R. 193-209) was denied May 24, 1951. (R. 210.) The jurisdiction of this Court is invoked under the provisions of 28 U. S. C. 1254.

This proceeding involves alleged additional income taxes for the years 1943, 1944 and 1945. The 90-day letters of the Commissioner of Internal Revenue claiming deficiencies as follows:

Petitioner	Docket No.	1943	1944	1945
J. Charles Pearson, Jr.	20413	$ 239.08	$397.54	$210.98
Helen Blesi Pearson	20414	1,498.00	533.37	576.94

were mailed June 25, 1948. (R. 9.) The petitions to the Tax Court of the United States were filed September 20, 1948. (R. 3, 150.) The findings of fact and opinion of the Tax Court were promulgated November 30, 1949. (R. 119.) The decisions of the Tax Court entered March 10, 1950 (R. 131, 169) determined deficiencies for Mrs. Pearson for the years 1943, 1944 and 1945 in the respective amounts of $826.46, $138.00, and $169.54 and for Mr. Pearson, over-

payments for the years 1943 and 1945 in the respective amounts of $277.06 and $142.35 and a deficiency for the year 1944 in the amount of $17.25. On May 26, 1950, the Commissioner filed his assignments of error and petition for review by the Court of Appeals for the Fifth Circuit. (R. 132.) The decision of the Court of Appeals for the Fifth Circuit reversing the Tax Court and remanding the cause with directions to restore the deficiency was rendered April 11, 1951. (R. 185.) The petition for rehearing filed May 2, 1951 (R. 193) was denied May 24, 1951. (R. 210.)

QUESTION PRESENTED

Petitioner, Helen Blesi Pearson, inherited an interest in a certain income producing property, being real estate which was subject to a long-term lease extending beyond the useful life of the building thereon which was erected prior to the decedent's death by and at the sole expense of the lessee. Under the lease, all improvements then or thereafter placed upon the leased premises became and remained the property of the lessor (R. 28) and the lessee was obligated, upon expiration of the lease, to yield up the building, wear and tear excepted, in a good tenantable condition. (R. 42.) The stipulated minimum fair market value of the building (at least $450,000) (Stip. 12, R. 26) at the time of decedent's death was in excess of the amount ($412,500) the Commissioner had determined to represent the value of the decedent's interest in the entire property for estate tax purposes. (Stip. 9, R. 25.)

The question presented is: under these facts and under a proper construction of Secs. 24 (l), 114 (a), 113 (b) and 113 (a) (5) of the Internal Revenue Code, does the petitioner have a basis for depreciation based on the fair market value of the building at the time she acquired her interest in it by inheritance from her mother?

STATUTES AND REGULATIONS INVOLVED

The applicable provisions of the statutes and Regulations involved are set forth in the Appendix, *infra*.

Statement

A portion of the facts in these consolidated cases was stipulated (R. 22-27), and a portion was adduced by testimony. (R. 44-119.) As found by the Tax Court, the pertinent facts may be summarized as follows:

The taxpayers were husband and wife who, on a community basis, being residents of Texas, reported the income from and claimed a deduction for depreciation or amortization with respect to certain property in their separate income tax returns. The cases were consolidated in the Tax Court for hearing purposes but separate decisions were entered. (R. 131, 169.) The court below ordered the cases consolidated for record, briefing, hearing and decision (R. 142-145), the order providing that the decision in *Commissioner v. Helen Blesi Pearson* shall be the decision in the case of *Commissioner v. J. Charles Pearson, Jr.* but that separate judgments should be entered in each case. Because of the identity of the issues presented and because the property in question was inherited by her, the wife will be referred to as the petitioner. (R. 121.)

On March 1, 1919, the petitioner's grandparents Charles T. Rowan and Ellen Rowan, executed a lease on certain property which they owned in community, the property being located in downtown Dallas, Texas. The lease was for a term of 66 years and 10 months, beginning March 1, 1919, and ending December 31, 1985. (R. 121, 122.) The lease also provided that the lessee should remove the existing improvements on the property and erect thereon a building of specified, minimum requirements, which was to cost not less than $100,000. It was provided that all improvements erected on the premises should become and remain the property of the lessors. When the existing buildings were demolished in 1926, Ellen Rowan had an adjusted basis therein of $35,000, amortization deductions for which she claimed and was allowed in her subsequent income tax returns in the annual sum of $583.33 based on the remaining 60-year period of the lease. (R. 123.) The lease provided (R. 123):

> Upon the termination or forfeiture of this lease peaceable possession of the premises in question shall be delivered over to the Lessors or their representatives, wear and tear excepted, in a good tenantable condition.

In 1928, the lessee constructed a 10-story building on the property at an approximate cost of $500,000. In 1935, an additional six floors and penthouse were completed at a cost of $485,205.91. The building, known as the Gulf States Building, has an estimated useful life of 50 years from the time of its completion in 1928. (R. 123.)

On July 14, 1919, Charles T. Rowan executed a deed conveying his entire interest in the property to his wife, Ellen Rowan. He died in 1924. Shortly thereafter, on August 10, 1924, Ellen Rowan executed a warranty deed conveying her interest in the property in equal shares to her three children, one of whom was the petitioner's mother, Mrs. Mae Lee Blesi. This deed was not recorded until July 16, 1940, that being shortly after the death on June 20, 1940, of Ellen Rowan. (R. 122.)

The federal estate tax return filed for the Estate of Ellen Rowan made reference to the property here considered but did not include in the gross estate any value with respect to it because of the deed dated August 10, 1924, referred to above, whereby Ellen Rowan conveyed her interest in this property to her three children. The Commissioner, however, on the ground that the deed had not been delivered to the children, and for other reasons, adjusted the estate tax return to include a value of $412,500 for the interest of Ellen Rowan in this property, giving the following explanation (R. 124):

> This property was under a 66-year lease at $16,500.00 per year net rental payable monthly is centrally located and improved with an excellent office building of about fourteen stories and any improvements on the lot will revert to the lessors at the expiration of the lease in 1985. Recommended value based upon allowance to the Estate of four per cent return on their investment.

This adjustment was agreed to and additional estate tax was paid accordingly. (R. 124.)

Mrs. Mae Lee Blesi, the petitioner's mother, was one of the three children to whom Ellen Rowan transmitted her interest in the property. The taxpayer inherited all of her mother's undivided interest in the property on her mother's death in 1941. The petitioner has since held the property for business use and production of income. (R. 122.)

In the estate tax return of the petitioner's mother a value of $137,500 was included (as property previously taxed), that sum being one-third of the valuation used by the Commissioner in adjusting the estate tax return of Ellen Rowan's estate. The Commissioner made no adjustment in respect to this inclusion in Mrs. Blesi's estate tax return. (R. 124, 125.)

The City of Dallas assessed values for the Gulf States Building and land for the years 1940 and 1941 as follows (R. 125):

	1940	1941
Land value	$348,753.00	$348,753.00
Building Value	488,647.00	493,507.00
Total Value	$837,400.00	$842,260.00

No outstanding mortgage existed against the Gulf States Building either in 1940 or 1941. (R. 125.) It was stipulated (R. 26) and the Tax Court so found (R. 125) that the fair market value of the Gulf States Building in both 1940 and 1941 was at least $450,000. The Tax Court found that a reasonable return on an investment in similar

property located in downtown Dallas, Texas, was eight per cent. (R. 125.)

During 1942, 1943, 1944, and 1945, the lessee claimed depreciation on the cost of the Gulf States Building on a basis of a 50-year life, which depreciation was allowed by the Commissioner. (R. 125.)

During the taxable years the petitioner (together with her husband) claimed a total yearly deduction for depreciation or amortization of $3,197.70 which was disallowed by the Commissioner. (R. 9-20, 156-167.) The Tax Court, five judges dissenting, refused to uphold the Commissioner's deficiency determinations holding that the petitioner was entitled to at least as much depreciation as was claimed on the income tax returns. The $3,197.70 depreciation deduction was claimed on the basis of a total value of $412,500, (the value the Commissioner included in Ellen Rowan's gross estate for her interest in the property) petitioners' interest being figured as one-third of $412,500 or $137,-500, and dividing by 43 as the approximate number of years remaining in the lease-term from 1942. (R. 128.)

On appeal by the Commissioner, the Court of Appeals reversed with directions to restore the deficiencies based on disallowance of the deductions for depreciation in controversy. (R. 191, 192.) A petition for rehearing filed by the petitioners was denied by the Court of Appeals. (R. 210.)

Reasons For Granting the Writ

1. This case presents a question of large and continuing importance in the functioning of the federal tax laws which

has not been, but should be, settled by this court. The issue involved arises whenever a taxpayer inherits the property of an individual who has leased the property for a long term to a lessee who, at his own expense, has constructed a depreciable improvement on such property.

Throughout the country there must be hundreds, perhaps thousands, of instances wherein the lessee of leased property has erected a substantial depreciable improvement at no cost to the lessor. According to the terms and conditions of the lease, or possibly due to the provisions of local law, the improvement may become and remain the property of the lessor immediately upon its construction or it may not become the property of the lessor until a forfeiture, termination or expiration of the lease occurs. Normally such leases are for long periods of time, the lease term frequently extending beyond the reasonable, estimated useful life of the improvement. Consequently, it is to be expected that the lessor-owner will die before expiration of the lease, the property thereby being acquired by another person by bequest, devise or inheritance.

In such a case, the regulations provide that the cost borne by a lessee for permanent improvements on leased ground is a capital investment recoverable by him in the form of rentals by way of annual deductions from gross income of amounts equal to the total cost of the improvements divided by the number of years remaining of the lease term. It is provided that such deductions shall be in lieu of deductions for depreciation. Regulations 111, Sec. 29.23 (a)-10-Rentals.

If the lessee in such a situation is not to have depreciation on an obviously wasting asset built at his own cost, such cost being recoverable as additional rental expense, does the event of death of the lessor-owner bring into operation the statutory income tax pattern in such manner as to confer upon the decedent's taker a fair market value basis in the property for depreciation as well as for gain or loss purposes? Since our present income tax system has been in operation fewer than forty years it seems reasonable to expect that situations such as the instant one will develop with increasing frequency due to deaths of lessor-owners involved in numerous existing and future leases. Thus it is important from the viewpoint both of taxpayers and the Government that the question here involved be settled by the highest authority at the earliest possible date.

The lower courts have reached conflicting results. The trial court in the instant matter decided in favor of the taxpayer, and the court below in favor of the Commissioner. In *Charles Bertram Currier*, 7. T. C. 980, the Tax Court held in favor of the taxpayer. The Commissioner at first acquiesced in the decision (1947-1 CB 2), thus agreeing to the legal principle established. Later, after this controversy arose, the Commissioner withdrew his acquiescence in the *Currier* decision. (1950-2 CB 5.) In other words, the Commissioner first considered *Currier* to be a correct statement of applicable law. Now, by appealing the Tax Court decision below, he is trying to cast doubt on the legal principle so clearly enunciated in *Currier* as well as in the Tax Court opinion below. In *Mary Young Moore*, 15 T. C. 906 the Tax Court held in favor of the taxpayer. The Com-

missioner did not acquiesce in that decision. (1951-15 Int. Rev. Bull. 1.) The *Moore* case is now pending before the United States Court of Appeals for the Ninth Circuit on a petition for review filed by the Commissioner July 10, 1951 and also on a petition for review filed by the taxpayer July 18, 1951. In these three cases *Currier*, *Pearson* and *Moore*, the Tax Court found in favor of the taxpayer in situations where the original lessor owned the improvements the lessee constructed under terms of the leases.

In situations where the lessor did not own the improvements or would not own them until a forfeiture, termination or expiration of the lease occurred the results have been different. In *Friend v. Commissioner*, 119 F. 2d 959 (C. A. 7th), certiorari denied 314 U. S. 673, the decision was for the Government. The estate did not own the buildings erected at the expense of the lessees. This is shown in the Board of Tax Appeals opinion 40 B. T. A. 768, at 771, rather than in the Circuit Court decision. This last is a much misunderstood and misunderstanding case in that it completely overlooks the provisions of Sec. 114 (a). Similarly, in *The First National Bank of Kansas City v. Nee*, ... F. 2d ..... (C. A. 8, June 7, 1951—present status unknown) the decision went for the Commissioner. This was on petition to review the District Court of Missouri decision at 92 F. Supp. 328, modifying a former decision at 85 F. Supp. 840.

Under the circumstances, delay in final determination of the question, incident to further litigation in the lower courts and in particular pending decision by other Courts

of Appeals, will work against proper tax administration and the public interest.[1]

The importance of the questions and proper construction of Internal Revenue Code provisions, some of which are here involved, prompted granting of certiorari in *Crane v. Commissioner*, 331 U. S. 1. The Circuit Court had reversed 3 T. C. 585. Importance of the questions and frequency of the situations, respectively, prompted granting of certiorari in *Commissioner v. South Texas Lumber Co.*, 333 U. S. 496, 68 S. Ct. 695 and *Manning v. Seeley Tube & Box Co. of New Jersey*, 338 U. S. 561, 70 S. Ct. 386.

2. The court below has decided a federal tax question in a way probably in conflict with applicable decisions of this Court. The decision below rather grudgingly agrees with the general view of the Tax Court that there is no necessary inconsistency in the holding that, though an an-

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1. The prospect of further litigation on the issue is reviewed by certain federal tax commentators in recent publications. At 1951 P-H par. 70,350 it is said:

"In view of the Pearson decision, there seems to be no doubt that the Commissioner will litigate this question further in other cases."

In Lawyer's Weekly Report by P-H, Inc., Volume 6—No. 47, August 13, 1951 it is said:

"'MOORE' ON DEPRECIATION OF INHERITED PROPERTY: Not so long ago we mentioned two decisions of different Courts of Appeals denying an heir's claim for depreciation on a building erected by a lessee on inherited property—where the term of the lease exceeded the useful life of the building [Pearson, CA-(5), 4/11/51; First National Bank, CA-(8), 6/7/51]. The Tax Court had previously allowed depreciation in such a case [Moore, 15 TC (No. 116)—]

"The Commissioner has announced his non-acquiescence in *Moore* and has filed an appeal. Apparently he has taken heart from the two Court of Appeals' decisions. Taxpayers claiming such a deduction can clearly look forward to litigation on this issue if they want it to stick."

In commenting on the problem involved in the *Currier*, *Pearson*, *Moore* and *First National Bank of Kansas City v. Nee* cases the Federal Tax Coördinator prepared by the Research Institute of America at Sec. F-3904.1 observes:

"While the principle set forth seems to be clearly established, its application to individual cases and the results to be reached have been neither uniform nor consistent."

cestor-lessor, having no cost basis, does not have a depreciable interest in a building erected by a lessee, an heir may, "as an incidence of estate taxation," and, under Sec. 113 (a) (5), I. R. C., have a basis for depreciation and an interest to depreciate. The court, however, asserts that the instant case is not one for such a holding. (R. 188.) In the course of its decision, the court below refers some ten or twelve times to the estate tax, its incidence, the estate tax valuation, the value of the interest of taxpayer's ancestor in the property as included in her gross estate at a total of $412,500, and the like.

In *Crane v. Commissioner*, 331 U. S. 1, 67 S. Ct. 1047, a case of inherited realty, this Court held that the devisee's basis for the property was its entire fair market value at the date of the death of decedent and not just the decedent's "equity" therein as determined by the Tax Court. At the time of death the property had against it a substantial mortgage. Its value was appraised for estate tax purposes as at the amount of the encumbrance, no suggestion being made that its real fair market value might actually have exceeded such appraisal. This Court, giving effect to the parties' stipulation as to allocation of the total basis to land and building, held that the full fair market value of the building was the basis for depreciation as well as for gain or loss purposes, whether the mortgage was assumed or not. This Court said the word "property" as used in Sec. 113 (a) (5) includes not only "the physical thing which is a subject of ownership" but also "the aggregate of the owner's rights to control and dispose of that thing." This Court concluded that the proper basis under Sec. 113 (a)

(5) is the value of the property, undiminished by mortgages thereon (i. e., not just the decedent's "equity" therein). Is it not to be presumed that the decision would have been the same whether or not such property was at the time vacant, entirely leased, rented in part, in some other status of use or disuse?

The Commissioner here presents the same line of argument, that there is no depreciable "cost" basis, that failed in *Brown Shoe Company, Inc. v. Commissioner*, 339 U. S. 583, 70 S. Ct. 820, which quoted with approval from *Commissioner v. McKay Products Corporation*, 178 F. 2d 639 (C. A. 3rd) *certiorari granted*, dismissed on Government's motion. In both cases the taxpayer received cash and property from community groups as inducements to location or expansion of factory operations in the communities. On grounds similarly urged here, the Commissioner disallowed depreciation on the exhaustible assets asserting the taxpayers had no "cost." This Court held to the contrary. This Court in *Brown Shoe* found the cash and value of buildings were contributions to capital by the community groups. In *McKay Products Corporation* a "gift" approach was used and a substituted basis was found under Sec. 113 (a) (2)[2].

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2. In *Brown Shoe* the Supreme Court considered its interpretation to be "in harmony with broad congressional policy as to depreciation deductions" quoting *McKay Products Corp., supra*, 178 F. 2d 643:

"* * * the assets received * * * are being used by the taxpayer in the operation of its business. They will in time wear out, and if [the taxpayer] is to continue in business, the physical plant must eventually be replaced. Looking as they do toward business continuity, the Internal Revenue Code's depreciation provisions—*and especially those which provide for a substituted rather than a cost basis*—would seem to envision allowance of a depreciation deduction in situations like this * * *." (Emphasis added.)

(Footnote 2—Continued on p. 15)

In the *Crane* case certiorari was granted because of the importance of the questions raised as to the proper construction of the gain and loss provisions of the Internal Revenue Code. In *U. S. v. Cumberland Public Service Co.*, 338 U. S. 451, 70 S. Ct. 280, certiorari was granted "to clear up doubts arising out of the *Court Holding Co.* case." It is respectfully submitted here that certiorari should be granted to clarify doubts and confusion created by the decision below with respect to important questions involving basis concepts arising out of *Crane, Brown Shoe* and other decisions of this Court.

3. The decision of the court below is in conflict with the decisions of other Courts of Appeals on the same matter. The controlling point in this case is the correct interpretation and application of Sec. 113 (a) (5), I. R. C. That section unequivocably states that the basis of property acquired by devise is the fair market value at the time the property is acquired. It is true that the Regulations, Reg. 111, Sec. 29.113 (a) (5)-1, say that for purposes of Sec. 113 (a) (5) the value of property at the date of death of the decedent "as appraised for the purpose of the Federal estate tax * * * shall be *deemed* to be its fair market value at the time of acquisition." (Emphasis added.) Until the decision of the court below, however, it had been uniformly held that

Footnote 2—(Continued)
Also in *Brown Shoe*, the Court, speaking of Sec. 718 (a) concerning invested capital for excess profits tax purposes said:

"That the excess profits tax provision characterizes capital contributions as being 'invested' and 'paid in' does not indicate, as the Commissioner urges, that the concept of capital is the constricted one of legal capital or capital originating with persons having a propriety interest in the business; *we think instead that the taxpayer's investment includes certain values which are properly 'treated as his investment,'* * * * *though not having cost to the taxpayer.* It would have been an oddity for Congress to make the inclusion of actual capital turn upon whether the transferor owned or failed to own one or two shares of stock in the corporatoin at the time of the transfer." (Emphasis added.)

the appraisal for federal estate tax purposes was merely presumptive and subject to rebuttal upon a showing of a different valuation.[3]

In this case the proof as to the fair market value of the depreciable property (the building) was not in dispute. Indeed, the parties stipulated that the fair market value of the building, on the critical date, was at least $450,000.

If the court below had recognized that the fair market value of the building determined the basis, in the hands of the petitioner, for depreciation purposes there would have been no conflict with other Circuit Court decisions on this point. The court below gave lip service to the effect of Sec. 113 (a) (5) insofar as it established a new basis in the hands of the heir but by the court's application of Sec. 113 (a) (5) to this case it repudiated the clear meaning of that section. In short, the court held that the petitioner's only hope for a depreciable basis in the building was inextricably tied to the decedent's estate tax return and the fair market value of the inherited property was immaterial. There is no controversy over the fair market value of the building. Both parties agree that this value was at least $450,000. The effect of the court's decision is that the value

3. *Harriet M. Bryant Trust*, 11 T. C. 374, Acq. 1949-1 CB 1;
Malcolm Clifton Davenport, 6 T. C. 62, Acq. 1946-1 CB 2.
Anson Evans et al., Trustees, 29 B. T. A. 710;
Northport Shores, Inc., 31 B. T. A. 1013;
Lillian G. McEwan, 26 B. T. A. 726, Acq. XI-2 CB 6;
Elizabeth G. Augustus, 40 B. T. A. 1201 aff'd without mention on this point 118 F. 2d 38 (C. C. A. 6, 1941), cert. den. 313 U. S. 585;
Mertens' *Law of Federal Income Taxation, Sec. 59.12;*
Kennedy's *Federal Income Taxation of Trusts and Estates, Sec. 5.22, p. 550;*

of the property as reflected by the valuation for estate tax purposes is conclusive. Moreover, the court, for the first time, imposed upon the taxpayer the unwarranted burden of having to prove what portion of the valuation the Commissioner used for estate tax purposes was attributable to the depreciable property.

It is submitted that the decision of the court below is in conflict with the following Circuit Court decisions: *Blanchard v. Commissioner*, 184 F. 2d 438 (C. A.-3, 1950), which affirmed, per curiam, the Tax Court decision 8 T. C. M. 1088, Dkt. No. 12752 and *Rogers v. Helvering*, 107 F. 2d 394 (C. C. A.-2, 1939), affirming Board of Tax Appeals decision 31 B. T. A. 994.

In *Blanchard* the court was concerned with the valuation of stock on the date of the decedent's death for the purpose of determining the basis of the decedent's estate in the stock to measure gain or loss to the estate upon the sale of said stock. The only question involved was the fair market value of the stock at the time of the decedent's death. Upon trial the taxpayer contended the fair market value of the stock was in excess of the valuation placed on it for estate tax purposes. The Government contended the fair market value to be that employed in the filing of the estate tax return. The court said:

> That (estate tax) value is recognized as not conclusive.

Nevertheless, on this disputed fact issue the Tax Court found the fair market value to be that as contended by the Government. On appeal the Third Circuit affirmed and

said the only question involved was one of fact and found the Tax Court's finding was supported by substantial evidence.

In the *Rogers* case the Board of Tax Appeals held the fair market value of stock rather than the valuation used for estate tax purposes was controlling:

> The values at which the stock was returned for estate tax purposes are not controlling.

On appeal the Second Circuit recognized the question to be one of fact and that the Board's findings on the matter of fair market value had substantial support in the record.

Thus we find the Third and Second Circuits hold that the critical element for basis is the fair market value of the property transmitted at death whereas the court below holds that the value employed for estate tax purposes is conclusive.

We feel that the basic difficulty here is the Commissioner's determination of the value of the estate. Clearly the decedent owned the land and the building at the time of death and this property was includible in the estate for estate tax purposes. Nevertheless, the Commissioner being fully informed of the facts determined the value of the property to be $412,500. Whether or not this included land and building is immaterial especially in view of the undisputed fact that the deceased owned the building at the time of death. An error by the Commissioner in determining the value of an estate for Federal estate tax purposes will not deprive an heir of a basis in the property transmitted in the absence of estoppel. The Commissioner here

does not assert estoppel and indeed he would not in view of the fact that he was fully aware of all the facts relating to the estate at the time he determined the value of the estate. Even in cases where a question of estoppel has been involved the Commissioner has not been successful in urging the courts to establish basis by using the estate tax return or other methods rather than by applying the fair market value rule. *Commissioner v. Mellon*, 184 F. 2d 157 (C. A. 3rd, 1950); *United States v. Dickinson*, 95 F. 2d 65 (C. C. A. 1, 1938).

If the Commissioner failed to appraise or value the estate properly for estate tax purposes, the remedy lies in the provisions of the Code relating to estate taxation rather than in attempting to rectify the error by denying a taxpayer a deduction for depreciation so clearly provided for in the provisions of the Code relating to income taxes.

The Commissioner on his own initative included in the gross estate of Mrs. Rowan the sum of $412,500 as being the value of her interest in this property. Only the value of her interest could be subjected to estate tax under Sec. 811 (b) of the Code. On the other hand, Sec. 113 (a) (5) deals with the fair market value of the property inherited. In *Gump v. Commissioner*, 124 F. 2d 540, certiorari denied 316 U. S. 697, 62 S. Ct. 1292 it was said:

> It is elementary that estate taxes and income taxes are totally different in principle and concept.

Neverthless, from its numerous references to estate tax, valuations therein and effects thereof, the court below must have considered that the stated estate tax value $412,-

500 was limiting of the fair market value of the property as a basis in petitioner's hands at the time of acquisition. Compare Secs. 811 (b) and 113 (a) (5) of the Code. If, as it seems, the decision was premised on that view it is not surprising that the court met with tread-mill difficulties apparent in the decision, going off, finally, on some reference to necessary proof. (R. 191.)

4. The decision of the court below involves such a departure from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision. This relates essentially to the remand of the court below with directions to the Tax Court to restore the deficiency. (R. 191.) Also, the decision below seems to assert a difference or distinction, in a case such as this, in the proof necessary to establish a new basis for gain or loss and that necessary to establish a new basis for depreciation. (R. 191.) Secs. 23 (l), 114 (a), 113 (b), and 113 (a) (5), Internal Revenue Code, certainly make no such distinction with regard to the necessary proof. The pertinent statutes make no differentiation either way as to the character or quantum of proof necessary to establish a basis under Sec. 113 (a) (5) for either purpose and none was recognized in the *Crane* case. Apparently, no differentiation in character or quantum of proof is recognized by the Treasury Department.[4]

4. In the brief for the Respondent in the *Crane* case, p. 21, it was said: This is the first case in which the practice of the Treasury Department in using the full value of the property as the basis both for depreciation and for determining gain or loss has been challenged. It was undoubtedly for this reason that some of the federal tax services adversely criticized the opinion of the Tax Court in this case. The court below said in its opinion:

> We cannot doubt, especially in view of the long uniform practice, that the right 'basis' for depreciation is the actual value of the buildings.

Perpetuation by non-action of this Court of this idea of some undefined distinction, asserted by the decision below to exist, between proof of basis necessary for gain or loss and that for depreciation (R. 191) can only lead to unfortunate confusion in decisions to come. Correction of that matter by this Court is imperative.

Here it was stipulated that the Commissioner adjusted the estate tax return of Mrs. Rowan to include in her gross estate the value of $412,500 for her interest in the property and that the fair market value of the building was at the time at least $450,000. (Stip. 9, 12, R. 25, 26.) The Tax Court so found. (R. 124, 125.) The Commissioner made no assignment of error as to these findings. (R. 136-139, 174-177.) The Tax Court opinion (R. 128) takes cognizance of such fact findings and, understanding that the petitioner claimed depreciation with respect to the building on only one-third of $412,500, or $137,500, instead of one-third of at least $450,000, or at least $150,000, concluded that the petitioner was entitled to at least as much depreciation as claimed on the return. The implication was that even more depreciation would have been appropriate.

Notwithstanding the stipulated facts and the absence of assignment of error with respect thereto, the court below, making light of the stipulation and finding of fact as to the fair market value of the depreciable asset, reversed and in effect rendered decision on that record. The explanation of the $412,500 adjustment in the gross estate of Mrs. Rowan shows the Commissioner saw the building on the property, read the lease covering it and made up his own mind as to the decedent's interest in it and the valuation

thereof. As recognized in the concurring opinion in the Tax Court, the Commissioner may well have been correct in his appraisal for estate tax purposes under all the circumstances. (R. 130.) The stipulated fair market value of the building itself was at least $450,000 which, viewing all circumstances, was conservative enough. The City ad valorem tax valuation at the time of acquisition far exceeded that sum. Actually, the fair market value of the building was possibly upwards of $900,000. There was nothing inequitable to the Government for the petitioner to claim a lower basis for depreciation than the facts would justify. Yet, the Court of Appeals here reversed the Tax Court and, in effect, rendered decision.

Preferred procedure would have been to remand the case to the Tax Court for further proceedings under appropriate instructions if the court below could not find itself in accord with the realities of the situation. Merten's Law of Federal Income Taxation puts it this way, Vol. 9, p. 399, Sec. 51.19:

> Unless the findings of the Board involve a mixed question of law and fact, the court may not properly substitute its own judgment for that of the Board. If the Board has failed to make an essential finding and the record on review is insufficient to provide a basis for final determination, the proper procedure is to remand the case for further proceedings before the Board.

That authority states by footnote that the sentence last quoted is a verbatim statement from *Helvering v. Rankin*,

295 U. S. 123, 55 S. Ct. 732. In support of that proposition he cites also *Helvering v. National Grocery Co.*, 304 U. S. 282, 58 S. Ct. 932. Certiorari in that case was sought on a departure from the accepted and usual course of judicial proceedings. It was granted because of the importance in the administration of the revenue laws of the matter presented. Compare also *Commissioner v. Scottish American Investment Co., Ltd.*, 323 U. S. 119, 65 S. Ct. 169. While the proposition generally may today be somewhat clouded by the repeal of the rule in *Dobson v. Commissioner*, 320 U. S. 489, 64 S. Ct. 239, by the amendment to Sec. 1141 (a) I. R. C. by Sec. 36 of Pub. Law 773, 80th Cong., 2nd Sess., 62 Stat. 869, providing review of Tax Court decisions "in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury," a remand by the court below with appropriate instructions seems more consistent with the accepted and usual course of judicial proceedings.

The decision of the court below did not adopt either the petitioner's or respondent's theory of the case. Indeed, the court pitched its decision upon a basis not considered important by either party. The taxpayer contended that under Sec. 113 (a) (5) the fair market value of the building at the time inherited, in a minimum amount established by agreement of the parties, was her basis for depreciation deductions for income tax purposes. The Government's position was that since the taxpayer's ancestor had no "cost" in the building the taxpayer was not entitled to any depreciation. Neither party contended that the estate tax valuation was conclusive on the taxpayer or the Government in

determining her basis for depreciation purposes. In view of the holding by the court below that the fair market value of the building when inherited was immaterial and that the estate tax valuation and that alone would furnish the taxpayer a basis for depreciation only if the taxpayer proved what, if any, portion of it was attributable to depreciable property, the court, in fairness to the parties and in furtherance of its views of the problem, should have remanded the cause to the Tax Court for further findings as to what portion of the estate tax valuation was attributable to the building.

Conclusion

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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August, 1951

APPENDIX

(All Emphasis Added)

INTERNAL REVENUE CODE:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) Expenses.—

(1) Trade or Business Expenses.—

(A) In General.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including * * * rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

* * * * *

(l) Depreciation.—A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

* * * * *

(n) Basis for Depreciation and Depletion.—*The basis* upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of *any* property *shall be as provided in section 114.*

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(a) Basis for Depreciation.—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of *any* property *shall be* the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property.

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(b) Adjusted Basis.—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, *shall be* the basis determined under sub-section (a), adjusted as hereinafter provided.

(1) General Rule.—Proper adjustment in respect of the property shall in all cases be made—

(B) In respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed (but not less than the amount allowable) under this chapter or prior income tax laws.

(a) Basis (Unadjusted) of Property.—The basis of property shall be the cost of such property; except that—

(5) Property Transmitted at Death.—If the property was acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent, the *basis shall be the fair market value* of such property at the time of such acquisition * * *.

SEC. 811. GROSS ESTATE.

The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property * * *

(a) Decedent's Interest.—*To the extent of the interest therein of the decedent at the time of his death;* * *

REGULATIONS 111:

SEC. 29.23 (a)-10. Rentals.—* * * The cost borne by a lessee in erecting buildings or making permanent improvements on ground of which he is lessee is held to be a capital investment and not deductible as a business expense. In order to return to such taxpayer his investment of capital, an annual deduction may be made from gross

income of an amount equal to the total cost of such improvements divided by the number of years remaining of the term of lease, and *such deduction shall be in lieu of a deduction for depreciation.* If the remainder of the term of lease is greater than the probable life of the buildings erected, or of the improvements made, this deduction shall take the form of an allowance for depreciation.

SEC. 29.23 (l)-1. Depreciation.—A reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business, or treated under Section 29.23 (a)-15 as held by the taxpayer for the production of income, may be deducted from gross income. *For convenience such an allowance will usually be referred to as depreciation,* excluding from the term any idea of a mere reduction in market value not resulting from exhaustion, wear and tear, or obsolescence. The proper allowance for such depreciation is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate), whereby the aggregate of the amounts so set aside, plus the salvage value, will, at the end of the useful life of the depreciable property, equal the cost or *other basis of the property determined in accordance with section 113* * * *.

SEC. 29.23 (l)-4. Capital Sum Recoverable Through Depreciation Allowances.—The capital sum to be replaced by depreciation allowances is the cost or *other basis of the property* in respect of which the allowance is made. (See sections 113 (a) and 114.) * * * In the case of the acquisition on or after March 1, 1913, of a combination of depreciable and nondepreciable property for a lump price, as, for example, buildings and land, the capital sum to be replaced is limited to an amount which bears the same proportion to the lump price as the value of the depreciable property at the time of acquisition bears to the value of the entire property at that time.

SEC. 29.113 (a) (5)-1. BASIS OF PROPERTY ACQUIRED BY BEQUEST, DEVISE OR INHERITANCE.—

(a) Property Included.—Section 113 (a) (5) applies—

(1) *to all property* passing from a decedent by his will or under the law governing the descent and distribution of property of decedents; * * *.

(b) Basis.—Section 113 (a) (5) provides three rules for determining the basis of property transmitted at death, first, a rule governing property generally, second, a special rule governing stock in a foreign personal holding company, and third, a special rule applicable to both the first and second rules in certain cases where for estate tax purposes the decedent's gross estate is valued at the optional valuation dates.

(1) General Rule.—Except as prescribed in paragraphs (2) and (3) of this subsection the basis of property acquired from a decedent by will or under the law governing the descent and distribution of the property of decedents is the *fair market value at the time of such acquisition.* Since, under the law governing wills and the distribution of the property of decedents, all titles to property acquired by bequest, devise, or inheritance relate back to the death of the decedent, even though the interest of him who takes the title was, at the date of death of the decedent, legal, equitable, vested, contingent, general, specific, residual, conditional, executory, or otherwise, the time of the acquisition of such property is the death of the decedent * * *.

The purpose of the Internal Revenue Code, in prescribing a general uniform basis rule for property acquired by bequest, devise, or inheritance, is, on the one hand, *to tax the gain, in respect of such property, to him who realizes it* (without regard to the circumstance that at the death of the decedent it may have been quite uncertain whether the taxpayer would take or gain anything); *and,* on the other hand, *not to recognize as gain any element of value solely from the circumstance that the possession or enjoyment of the taxpayer was postponed.* Such postponement may be, for example, * * * *until the period of the possession or enjoyment of another has terminated,* * * *.* It is the

increase or decrease in the value of property reflected in a sale or other disposition which section 113 (a) (5) recognizes as the measure of gain or loss * * *.

(c) Fair Market Value.—For the purposes of this section, the value of the property as of the date of the death of the decedent as appraised for the purpose of the Federal estate tax * * * or if the estate is not subject to such tax, its value appraised as of the date of the death of the decedent for the purpose of State inheritance or transmission taxes, shall be *deemed* to be its fair market value at the time of acquisition.